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Introduction

Most of the crop agriculture in Louisiana is produced on rented land. Many of the existing rental arrangements are based on a "gentleman's agreement" and have been in existence for some time. Over time, the existence of these types of arrangements becomes less common. As conditions change and new arrangements are negotiated, landlords and tenants often struggle with the question of determining a fair rental rate. Rental arrangements vary widely across the state and region. The purpose of this publication is to help tenants and landlords make better informed decisions and develop fair rental arrangements.

Types of Rental Arrangements

Cropland is generally rented under one of three ways: (1) crop-share, (2) cash rent or (3) cash/share combination. Under the crop-share arrangement, the landowner receives a share of the crop for a contribution of the use of the land. In some cases, the landowner may contribute proportionally to other inputs in the production process. Advantages of a crop-share lease are: (1) it is a popular leasing method and most provisions are easily understood, (2) price and yield risk are shared, (3) landowner is relieved of making many decisions, (4) both parties share in benefits from new technology (Langemeier). In addition, the landlord and tenant generally share government payments, both agricultural market transition act (AMTA) payments and loan deficiency payments (LDP), in proportion to rental arrangement. Disadvantages of a crop-share lease are: (1) landowner still has to make decision on marketing share of crop, (2) if landowner shares in expenses, bills must be paid within a reasonable time, (3) changes in technology may benefit one party over the other and (4) cropping programs and government program participation may be difficult areas for agreement between landowner and tenant (Langemeier).

Cash leases account for the largest percentage of leases in Louisiana. Under a cash rental arrangement, the tenant agrees to pay a specified amount of money each year for the use of the farm. Payment of the rental amount may be split into two installments, one before spring tillage and the other after crops are harvested. Advantages of the cash rental arrangement are: (1) the lease is simple and easy to understand, (2) landowners are relieved of production and marketing decisions, (3) the tenant has more freedom to develop and carry out cropping program and (4) the landowner knows his income and does not share in price and yield risks (Langemeier). Disadvantages are: (1) determining a fair lease is difficult, (2) tenant assumes all yield and price risk, (3) cash rents often based on historical data and may not reflect the current production and (4) under cash rent, a tenant may be more likely to mistreat the land (Langemeier). Under cash rental arrangements, landowners generally are not entitled to government payments (AMTA or LDP).

Flexible or variable leases may take on a variety of forms. Five methods of structuring flexible leases are: (1) cash rent equal to a specified percentage of gross crop value, (2) adjusting lease payment based on price and yield in a given year relative to the average, (3) base rent plus bonus, (4) adjustment for price only and (5) adjustment for yield only (Langemeier). Flexible leases attempt to incorporate the best characteristics of both the share and cash rental agreements. The common characteristic of all methods is that the rental payment fluctuates as price and/or yield changes.

Determining Cash Rental Rates

How are cash rental rates determined? In areas where cash rent is the norm, the prevailing cash rent market will help determine the fair rent. If an active cash rent market does not exist in an area, then some alternatives have been suggested that help set the parameters for rate negotiation. These include factors such as the landowner's cost, the amount the tenant can afford to pay and/or the crop share adjusted for risk (Langemeier).

The landowner's cost is essentially the opportunity cost of the land investment, less expected capital gains, plus real estate tax. For the landowner, there is a certain expectation of a return on the investment in land. The net rate of return can be estimated using the historical rent-to-value ratio. In this case the cash rent is calculated by multiplying the rent-to-value ratio by the market value of land. While this approach sounds simple and straightforward, the market value of land of a particular quality may not be easily determined. This is especially true in areas where there is considerable variation in land quality and/or there is not an active market for farm land.

Another alternative is to use the concept of "amount a tenant can afford to pay" to establish cash rents. Under this approach, the tenant receives all income and pays all expenses and the amount left is available for cash rent to the landowner. Generally, this approach will yield the upper bound on the amount of cash rent a tenant can pay, and the first approach will yield the minimum amount a landowner is willing to accept. For individual situations, these two values may be reversed, or the amount a tenant can afford to pay is less than the rental rate based on market value.

Since most tenants and landowners are familiar with share arrangements, another alternative is to use a crop-share approach to determine cash rental rates. Under this approach the cash equivalent of an equitable share crop arrangement is determined and adjusted for risk. Some adjustment is appropriate since the tenant assumes all of the price and yield risk under a cash rental arrangement. It should be noted that the differential between cash and share rents is not always observed in the real world. Any number of factors might account for this situation. Some of these include: concern about the stewardship of the tenant, length of the agreement, demand for rental land or other reasons.

Determining Share Rental Rates

Determining a fair and equitable share rental rate is relatively easy to define, but more difficult to implement. In theory, all contributions to the production process made separately by the landlord and tenant should be identified, and each party is compensated based on his or her relative contribution. This assumes that returns to land are the same as or similar to returns to non-land inputs. Good crop-share leases should follow five basic principles (Langemeier): (1) yield-increasing inputs should be shared, (2) share arrangements should be adjusted as technology changes, (3) total returns should be divided in the same proportion as resources contributed, (4) long-term investments should be compensated when the lease is terminated and (5) there must be good communication between landowner and tenant.

The basic underlying principle of a share rental arrangement is that the landlord and tenant should share in the proceeds of production in the same proportion they share in the cost of production. While this sounds simple and straightforward, it is generally very difficult to arrive at fair values for the contributions of both parties. One area where this is particularly true is the land contribution of the landlord. As a general rule, the current fair market value of land for agricultural purposes should be used with the influence of nearby urban areas removed. This value is then multiplied by the appropriate interest rate to obtain the annual land charge or value of the land contribution of the landlord. An interest rate of 5 percent to 7 percent is generally used because this represents the range of long-term returns to land in agricultural production. Any annual charges paid by the landlord for land development (lime, conservation practices, etc.) also should be included as a landlord contribution. If there is an active cash rent market, cash rents may be used to estimate the annual land charge.

On the other side of the ledger, equipment contributed by the tenant often presents difficulty in arriving at a fair value. One suggestion for placing a value on equipment is to use the average value of machinery necessary to farm in the area (Langemeier). This means that one would not use all new equipment or all old equipment values, but rather a mix of equipment of various ages representative of good farms in the area. These values can be used to estimate annual depreciation, interest on investment and repair charges as contributions of the tenant. Most farm equipment is depreciated over either a seven- or 10-year useful life. Repair charges can be estimated from records or published machinery cost data. An alternative to estimat ing a value of the equipment used by the tenant is to use average custom rates in the area.

Another area creating some problems in estimating a value is labor and management. These two items should be separated. Labor provided by the tenant should be valued at the going rate for farm labor in the area. Management may or may not be shared between the landlord and tenant. Langemeier suggests two alternatives for valuing management. These are: (1) a 1 percent to 2.5 percent of the average capital managed in the business (market value of land and machinery) or (2) professional farm managers typically charge 5 percent to 10 percent of adjusted gross receipts. Obviously, a value based on gross receipts may be highly variable from year to year as prices and yields vary over time.

Determining a Fair Flexible Cash Rent

The flexible or variable lease arrangement is an attempt to capture some of the best features of the cash and share rental arrangements. While there are several forms of the variable cash rent as noted above, the flexibility is generally introduced by either flexing for changes in crop price or flexing for both price and yield variations. Flexing for yield only is equivalent to the standard crop-share rental arrangement. There are a number of options for establishing a “price-only” flexible lease. Most options include some base rental amount plus some adjustment for price changes. Under this type of approach, the landlord and tenant agree on a base cash rent as long as current year’s price is within a specific range. If crop prices go above or below this range, then rent is adjusted by some agreed upon amount. For example, the landlord and tenant may agree on $30 per acre for soybean land as long as soybean prices are $5.50 - $6.00 per bushel. For every $0.25 change outside this range, land rent is adjusted $5.00 per acre. Alternatively, a base price might be selected and any deviation from the base would cause an adjustment (up or down) in the land rent.

The other general form of a variable lease is flexibility for both price and yield. In this case, the landlord and tenant must agree on the base yield and price for the crop year. Once the base is decided, it is important to be extremely clear on how yield will be measured and how the price will be determined. All of these should be determined and agreed upon at the beginning of the agreement.

Rental Arrangements in Louisiana

Rental arrangements in Louisiana are reported on a statewide basis by the National Agricultural Statistical Service (NASS). Table 1 shows rental rates and land values in Louisiana for the period 1996-2000 as reported by NASS. As shown in this table, average rental rates have been relatively stable over the reporting period. There may have been wide fluctuations in individual rental rates, but, when averaged across the state, these changes are not apparent. There has been a larger percentage change in pasture land rental rates compared to cropland over the same period. Land values also have been somewhat stable over the reporting period. Again, these values reflect values averaged across a wide variety of land qualities with varying production capabilities.

Table 1. Cash Rental Rates and Land Values, Louisiana 1996-2000.

Item	1996	1997	1998	1999	2000
Cash Rent, Cropland (Irrigated) $/ac	65.30	70.60	70.00	70.00	65.00
Cash Rent, Cropland (Non-Irrigated) $/ac	53.00	48.00	49.00	49.60	51.90
Cash Rent, Pasture land ($/ac)	12.60	13.00	16.00	15.50	14.00
Farm Real Estate Values ($/ac)	1180	1190	1210	1210	1250
Cropland Values ($/ac)	N/A	1080	1060	1060	1110
Cropland Values (Irrigated) ($/ac)		920	928	990	1060
Cropland Values (Non-irrigated) ($/ac)		1120	1100	1080	1120

Source: Agricultural Land Values and Agricultural Land Rents, National Agricultural Statistics Service/ USDA, Washington, D.C. March 2000, pp. 3-7.

Henning et al. also report rental arrangements for Louisiana from their survey of rural land values. These values are reported by crops and are summarized in Table 2. These rental rates are subjective estimates provided by respondents to the land value survey. Respondents to the survey are knowledgeable of the land market and familiar with rental arrangements in various areas of the state. Further, these results are presented for major enterprises across the state. Because the data from Henning et al. are presented by enterprise, these data are not directly comparable to the data in Table 1 that are aggregated across commodities. In addition, the NASS data do not report share rental arrangements. While data from the two sources are not directly comparable, they do tend to exhibit a great deal of consistency.

Table 2. Mean Cash Rental Rates and Representative Share Rental Rates, Louisiana, 1997-98.

Item	1997	1998
Cash Rent, Cotton	74.00	73.00
Cash Rent, Soybeans	35.00	34.00
Cash Rent, Corn	47.00	50.00
Cash Rent, Rice	46.00	59.00
Cash Rent, Pasture	14.00	14.00
Cash Rent, Recreation	6.00	11.00
Share Rent, Cotton	20%	20%
Share Rent, Soybeans*	25%	25% 20%
Share Rent, Corn	20%	20%
Share Rent, Rice	20%	20%

* Share rental rates for soybeans in 1998 evenly split between 25% and 20% share.

Source: Henning, S.H., L.R. Vandeveer, G.A. Kennedy. R. Summers and J.B. Breaux, "Louisiana Rural Land Values and Tenure Arrangements, 1997," A.E.A. Information Series No. 167, Department of Agricultural Economics and Agribusiness, LSU AgCenter. August 1998. Pp 30-33. Also preliminary information for 1998 update of above publication.

Summary

Obtaining the use of land for agricultural production through a leasing arrangement is a very common practice in Louisiana agriculture. The rental of land has a long history in American agriculture. This long history has given rise to customs and traditions in leasing agricultural land. These customs and traditions strongly influence the rental market in a given area. One positive aspect of the reliance on custom or tradition is that the rental market tends to be somewhat stable over time. While the stability is generally desirable, it also means that rental arrangements are generally slow to react to changing economic conditions. This, in turn, can lead to inefficient land use and distort resource allocation.

This publication provides a general overview of common types of leases. Also presented are some general guidelines to be used by landlords and tenants in developing equitable leasing arrangements. Data presented on existing rental arrangements in Louisiana suggest that cash rental rates have been relatively stable over time, but adjustments do occur in response to market conditions. The cash rental data from Henning et al. suggest that cash rents for higher value crops are more than cash rents for lower value crops.

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